

Audit



Report

OFFICE OF THE INSPECTOR GENERAL

ARMY NATIONAL GUARD MILITARY EQUIPMENT

Report No. 97-044

December 11, 1996

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Department of Defense

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Acronyms

ARNG	Army National Guard
CBS-X	Continuing Balance System-Expanded
DFAS-IN	Defense Finance and Accounting Service, Indianapolis Center
LOGSA	Logistics Support Activity
REQVAL	Requisition Validation System
SAMIS	Supply Accounting Management Information System
SPBS-R	Standard Property Book System-Redesign



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December 11, 1996

MEMORANDUM FOR CHIEF, NATIONAL GUARD BUREAU
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE
AUDITOR GENERAL, DEPARTMENT OF THE ARMY

SUBJECT: Audit Report on Army National Guard Military Equipment
(Report No. 97-044)

We are providing this audit report for information and use. We considered comments on a draft of this report in preparing the final report.

Comments on the draft of this report conformed to the requirements of DoD Directive 7650.3 and left no unresolved issues. Therefore, no additional comments are required.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Ms. Mary Lu Ugone, Audit Program Director, at (703) 604-9529 (DSN 664-9529) or Mr. John M. Donnelly, Audit Project Manager, at (703) 604-9549 (DSN 664-9549). See Appendix G for the report distribution. The audit team members are listed inside the back cover.

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Office of the Inspector General, DoD

Report No. 97-044
(Project No. 6RE-2016.01)

December 11, 1996

Army National Guard Military Equipment

Executive Summary

Introduction. The audit was performed as part of the Audit of the Consolidated Financial Report on Department 97 Appropriations¹ for Army National Guard and Reserve Equipment (Project No. 6RE-2016). The Army National Guard (the Guard) records and reports on military equipment acquisitions in its property book system. Guard property book officers provide military equipment acquisition and disposition information to a central Army automated equipment management system. Guard headquarters uses information in the automated system to update its general ledger accounts and to provide quarterly reports on military equipment to the Defense Finance and Accounting Service, Indianapolis Center (DFAS-IN). The Guard reported \$34.2 billion in military equipment assets to the DFAS-IN as of September 30, 1995.

Audit Objective. The audit objective was to determine whether the Guard properly capitalized² and classified military equipment recorded in the general ledger. We also evaluated the applicable management controls.

Audit Results. The Guard materially misstated military equipment balances included in the FY 1995 Army financial statements.

- o The Guard recorded and reported military equipment items that were below the Army capitalization threshold and, therefore, should have been expensed. As a result, the military equipment account was overstated by \$9.1 billion (Finding A).

- o The Guard misstated military equipment in transit as equipment in use. As a result, account 1762, Equipment in Use, was overstated by \$1.2 billion, and account 1770, Equipment in Transit, was understated by \$1.2 billion (Finding B).

Management controls could be improved by the Guard. We identified material management control weaknesses related to capitalization and classification of military equipment (Appendix A). Recommendations in the report, if implemented, will result in more accurate and meaningful reporting of Guard military equipment in the Army general ledger for FY 1996 and future years. See Part I for a discussion of the audit results.

Summary of Recommendations. We recommend that the Guard record and report the value of military equipment using established capitalization thresholds, make specific

¹The Department of the Treasury uses department code "97" to identify appropriations for the Office of the Secretary of Defense. Defense agencies receive their funding from Department 97 appropriations.

²Property purchased is "capitalized" when it is recorded as an asset in financial accounting records. The cost of property not capitalized is recorded as a current operating expense.

accounting entries to accurately record and classify military equipment account balances in the general ledger, and document procedures for recording and reporting military equipment transactions.

We also recommend that the Deputy Chief of Staff for Logistics provide general ledger account balances for military equipment to the Guard for accounts 1762, 1766, and 1770 and that DFAS-IN make appropriate accounting entries to accurately classify Guard military equipment in the Army general ledger.

Management Comments. The National Guard Bureau concurred with recommendations to record and report the value of military equipment using established capitalization thresholds, make accounting entries to accurately record and classify military equipment account balances in the general ledger, and document procedures for recording and reporting military equipment transactions. Corrective actions will be implemented by March 1997. The National Guard Bureau stated that the Guard will take or has taken actions to improve management controls by streamlining the financial reporting process and replacing its accounting system with a designated standard system that will be used by other Army major commands. The National Guard Bureau also stated that the Logistics Support Activity would provide the FY 1996 account information to the Army National Guard.

The DFAS-IN nonconcurred with the recommendation that it make appropriate entries to accurately classify Guard military equipment in the Army general ledger. The DFAS-IN stated that it cannot make correcting entries to Army National Guard reported data; however, DFAS-IN will advise the Army National Guard and request revisions if the data are not consistent with Army guidance.

See Part I for a discussion of management comments and Part III for the complete texts of management comments.

Audit Response. The National Guard Bureau comments are fully responsive. We commend the Army National Guard for the additional actions to strengthen its management control program, which will support the other actions taken in response to the recommendations and will generally enhance the Army National Guard accounting and financial reporting process. Although DFAS-IN nonconcurred, we considered its comments to be responsive, because the comments indicate the DFAS-IN will make accounting entries to accurately classify Guard military equipment upon receipt of adequate financial information from the Army National Guard. Therefore, additional comments are not required.

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Part I - Audit Results

Audit Background

We performed the audit in response to the Chief Financial Officers Act of 1990 (Public Law 101-576), which established requirements for Federal organizations to submit audited financial statements to the Director, Office of Management and Budget. Public Law 103-356, "The Federal Financial Management Act of 1994," requires DoD and other Government agencies to prepare consolidated financial statements for FY 1996 and each succeeding year. In a memorandum dated June 6, 1995, the DoD Deputy Chief Financial Officer advised DoD Components of the FY 1996 requirement to prepare and submit financial statements in accordance with the Federal Financial Management Act of 1994. This audit is one in a series of audits involving the National Guard and Reserve Equipment appropriation. Army National Guard (ARNG) military equipment, regardless of the appropriation that funded the purchases, is reported in the Army general fund financial statements.

Accounting and Reporting of Military Equipment. The ARNG submits a quarterly report to the Defense Finance and Accounting Service, Indianapolis Center (DFAS-IN) for military equipment. DFAS-IN uses the report to update ARNG equipment balances that are included in the Army general fund financial statements. The quarterly report is based primarily on ARNG property book officers' quarterly balances for military equipment. The ARNG September 30, 1995, report to DFAS-IN indicated \$34.2 billion in military equipment assets.

Logistics Support Activity. The Army Logistics Support Activity (LOGSA) is an Army Materiel Command organization that tracks and reports military equipment for all Army major commands, including the ARNG. The LOGSA provides DFAS-IN a monthly and fiscal yearend general ledger report on military equipment. DFAS-IN uses the reports as a subsidiary ledger for recording military equipment on the Army's financial statements. The FY 1995 LOGSA report to DFAS-IN included military equipment items with a unit price of \$50,000 and above owned by Army components, including the ARNG. The general ledger report is generated by the Requisition Validation System (REQVAL), which is operated and maintained by LOGSA. LOGSA has provided the general ledger reports to DFAS-IN since about June 1990. Military equipment included in the report was limited to equipment meeting the DoD capitalization threshold¹ in effect at the time of submission to DFAS-IN.

Audit Objective

The audit objective was to determine whether the ARNG properly capitalized and classified military equipment recorded in the general ledger. We also

¹The unit price at which an equipment item is capitalized. The DoD capitalization thresholds are shown in Table 1 (Finding A).

evaluated the applicable management controls. Appendix A provides details on the audit scope and methodology, and Appendix B includes a discussion of prior audits and other reviews.

Finding A. Capitalization of DoD Equipment Assets

The ARNG recorded and reported in general ledger asset accounts military equipment items that were below both the DoD and the Army's capitalization thresholds. The ARNG inappropriately recorded equipment items in general ledger asset accounts because the ARNG did not implement Army capitalization policy. As a result, we estimated that the ARNG general ledger military equipment asset account was overstated by \$9.1 billion, or about 27 percent of the reported military equipment.

Military Equipment Capitalization Requirements

DoD 7000.14-R, volume 4, "Financial Management Regulation," (the Regulation) January 1995, contains capitalization policy for DoD fixed assets. Equipment is capitalized when its acquisition cost is recorded in an appropriate asset account in the general ledger. The Regulation states that assets capitalized at a previous capitalization threshold shall continue to be capitalized at that previous capitalization threshold. Finding B provides details on the military equipment asset accounts. Equipment that is not capitalized is recorded at its acquisition cost as a current fiscal year operating expense in the general ledger. Equipment not Capitalized, account 6122, represents the acquisition cost of equipment that does not meet capitalization criteria.

The DoD has established capitalization thresholds for determining whether military equipment acquisitions should be capitalized or expensed. Table 1 shows the capitalization thresholds established by Congress since FY 1985.

Table 1. Capitalization Thresholds

<u>Fiscal Year</u>	<u>Threshold</u>
1985	5,000
1992	15,000
1994	25,000
1995	50,000
1996	100,000

DFAS-IN Regulation 37-1, "Finance and Accounting Policy Implementation," September 18, 1995, contains capitalization policy and criteria that implement DoD policy and criteria. DFAS-IN Regulation 37-1 provides guidance on accounting policy and equipment capitalization requirements to all Army finance and accounting offices, including those that support the ARNG.

Army Compliance with DoD Thresholds

The Army could not comply with DoD capitalization thresholds because Army property accountability systems, used to both track and report military equipment, do not track acquisition dates and historical cost. For that reason, on March 28, 1994, the Army Comptroller informed the Under Secretary of Defense (Comptroller) that the Army could not comply with DoD policy and requested permission to apply the then current capitalization threshold to all Army equipment, regardless of acquisition date. On May 4, 1994, the DoD Deputy Chief Financial Officer required the Army to disclose in footnotes to the Army's financial statements the inability to comply with DoD capitalization policy and to indicate the method the Army used to capitalize equipment. In its FY 1995 Financial Report, the Army stated that its property accountability systems used the FY 1995 \$50,000 DoD capitalization threshold as the basis for recording equipment in general ledger equipment asset accounts.

Recording Military Equipment

The ARNG records military equipment in general ledger asset accounts based on input from state reporting units. State units record on-hand and in-use accountable property in their property books. The majority of the state units use the Standard Property Book System-Redesign (SPBS-R) and the Supply Accounting Management Information System (SAMIS). State units then electronically transmit monthly SPBS-R and SAMIS major end-item transactions to the Continuing Balance System-Expanded (CBS-X), an Army-wide, equipment tracking system for major end items and selected secondary and stock fund equipment. The CBS-X has been modified to enable it to report financial information about military equipment. Military equipment balances from the CBS-X are periodically downloaded to and used by REQVAL. The ARNG accounting personnel use quarterly REQVAL reports as the basis for making the quarterly general ledger entries and for reporting general ledger balances to DFAS-IN.

Appendix C more fully discusses the SPBS-R, SAMIS, CBS-X, and REQVAL. Appendix D describes how information on military equipment assets flows from property books to the general ledger.

ARNG Capitalization Policy

The ARNG did not comply with the Army's capitalization policy to record as assets, in the ARNG general ledger, military equipment items with a unit price of \$50,000 and above. Instead, the ARNG recorded in its general ledger about \$9.1 billion in assets with unit prices below \$50,000. The assets were

Finding A. Capitalization of DoD Equipment Assets

inappropriately recorded because ARNG used Army logistics systems, which were not programmed to apply the Army's capitalization threshold, as the information source for recording military equipment assets in the ARNG general ledger. ARNG logistics systems showed a value of \$34.2 billion as of September 30, 1995. The \$34.2 billion represented the value of all military equipment items tracked by Army logistics systems. The ARNG should have recorded in its general ledger the \$25.1 billion of ARNG assets in the LOGSA September 30, 1995, report to DFAS-IN. Therefore, we estimated that the ARNG overstated the military equipment balance by about \$9.1 billion, the value of military equipment that did not meet the capitalization threshold and which, therefore, should have been expensed.

Equipment Below the Army Capitalization Threshold. The \$34.2 billion of military equipment assets included items that should have been expensed. Appendix E shows the \$34.2 billion of military equipment assets included in the ARNG general ledger as of September 30, 1995. The military equipment that should have been expensed consisted of low-cost items that did not meet the FY 1995 Army capitalization threshold of \$50,000. Table 2 illustrates the military equipment recorded in the ARNG FY 1995 general ledger that did not meet the Army capitalization threshold.

Table 2. Examples of Low-cost Items Capitalized as Military Equipment

<u>Equipment Items</u>	<u>Unit Cost</u>
Bassoon	\$6,500
Machine gun	5,864
Electronic equipment installation kit	5,493
Modulation meter	5,002
Signal generator	4,734
Field kitchen	3,322
Secure telephone unit	2,310
Saxophone	1,609
Grenade launcher	593
Automatic pistol	260
Telephone cable	109
Bayonet and scabbard	59
Rocket launcher	33
Cable reel	16
Bayonet knife	4

ARNG Military Equipment Meeting the Army Capitalization Threshold. The LOGSA September 30, 1995, report to DFAS-IN included ARNG military equipment, valued at \$25.1 billion, that met the Army capitalization threshold of \$50,000. Table 3 shows the types of military equipment included in the LOGSA general ledger report.

Finding A. Capitalization of DoD Equipment Assets

Table 3. ARNG Military Equipment Meeting the Army Capitalization Threshold

<u>Equipment Type</u>	<u>Reported Value¹ (millions)</u>
Tactical	
Aircraft	\$ 5,733.8
Missiles	1,370.3
Artillery weapons	210.1
Small arms	.3
Chemical weapons	0
Tanks	11,893.4
Other combat vehicles	0
Tactical weapons	2,188.4
Support vehicles	53.8
Electrical	1,629.3
Medical equipment	16.9
Other	<u>993.3</u>
Subtotal	\$24,089.6
Noncombat ²	<u>963.5</u>
Total	\$25,053.1

¹Source of military equipment balances is the LOGSA general ledger report, dated September 30, 1995, provided to DFAS-IN. As noted in footnote 2, the balances do not include noncombat equipment.

²The general ledger report does not include noncombat equipment that is assigned to nontactical (noncombat) units. Army major commands report noncombat equipment directly to DFAS-IN through local Defense Accounting Offices.

Even though the LOGSA monthly general ledger information provided to DFAS-IN included ARNG military equipment assets, DFAS-IN did not use the LOGSA information as the source for reporting ARNG FY 1995 military equipment assets. A DFAS-IN official stated that DFAS-IN used direct input from ARNG because the official believed that use of the LOGSA report may have resulted in duplicate reporting of nontactical equipment.

ARNG Capitalization Methodology. The ARNG did not document its established procedures for capitalizing and reporting the value of military equipment. DoD 7000.14-R, volume 1, requires documentation of accounting procedures. The ARNG should, therefore, document its procedures to capitalize and report military equipment for financial reporting.

Conclusion

The ARNG materially overstated the value of ARNG equipment assets and understated expenses. The ARNG needs to implement Army capitalization criteria to ensure that ARNG military equipment assets and noncapitalized equipment expenses are fairly and accurately stated.

Recommendations, Management Comments, and Audit Response

We recommend that the Director, Army National Guard:

A.1. Record and report Army National Guard military equipment using the capitalization thresholds established by the Logistics Support Activity for Army major commands, and make appropriate FY 1996 accounting entries to record Army National Guard military equipment assets on the Army National Guard general ledger.

A.2. Document the specific procedures established to record Army National Guard equipment for financial reporting.

Management Comments. The National Guard Bureau concurred with the recommendations, stating that the Army National Guard would make adjusting entries to the general ledger asset accounts to comply with the Army capitalization threshold and that the adjusting entries would be reflected in the general ledger as of September 30, 1996. Further, the Army National Guard general ledger reporting procedures will be documented, and corrective actions will be completed by March 1997.

In addition to planned corrective actions, the National Guard Bureau stated that the Army National Guard took additional actions to strengthen its management control program. In FY 1996, the Army National Guard streamlined its financial reporting process by implementing direct reporting of monthly financial data from state fiscal offices to the DFAS-IN. This action will result in Army National Guard reporting procedures conforming with those of the Army and in Army National Guard financial reports being more compliant with DoD reporting requirements. Additionally, the Army National Guard will replace its accounting system, which has repeatedly been materially noncompliant with DoD accounting requirements, with the Corps of Engineers Financial Management System. That system has been designated as the official accounting system for Army customers of the DFAS-IN. The Army National Guard will begin implementing the new system in FY 1998.

Finding B. Classification of ARNG Military Equipment Assets

The ARNG misstated military equipment general ledger accounts because the ARNG did not analyze and properly classify military equipment. As a result, ARNG overstated account 1762, Equipment in Use, by \$1.2 billion, and understated account 1770, Equipment in Transit, by \$1.2 billion.

Military Equipment Classification Requirements

The Regulation provides the DoD general ledger account structure for military equipment to include two summary accounts and seven subsidiary accounts. Table 4 shows the accounts applicable to the ARNG.

Table 4. Military Equipment Accounting Structure For ARNG

<u>Account Number</u>	<u>Account Title</u>
1760	Military Equipment
1762	Equipment in Use
1770	Equipment in Transit

The Regulation provides the following definitions for the accounts.

Military Equipment, account 1760 (Summary Account). Represents the net values of all accounts that begin with the numbers 176. Excludes all other summary accounts

Equipment in Use, account 1762. Represents the acquisition cost (which meets the capitalization criteria) of equipment used in producing items for sale or in mission accomplishments. Includes special tooling, special test equipment, military property, and plant equipment. Does not include equipment with contractors, testing agencies, defense industrial facilities, and others; equipment on loan; and equipment being incorporated into work in process or construction in progress.

Equipment in Transit, account 1770. Represents the acquisition cost (which meets the capitalization criteria) of equipment in transit from the vendor for which title has passed. Represents the net purchase price, transportation costs, modification costs, or site preparation costs as encountered.

Finding B. Classification of ARNG Military Equipment Assets

ARNG Military Equipment General Ledger Account

The ARNG inappropriately classified all military equipment in subsidiary general ledger account 1762, Equipment in Use, even though the ARNG owned about \$1.2 billion of military equipment in transit. The ARNG accounting personnel recorded all ARNG military equipment in subsidiary account 1762, Equipment in Use, based on quarterly input from ARNG logistics personnel. The ARNG logistics personnel used quarterly printouts from the REQVAL as the source for military equipment information. The REQVAL printout, used to report military equipment assets to the ARNG Accounting Division, was not programmed to disclose military equipment classifications. The REQVAL printout provided only the on-hand value of ARNG military equipment.

Army Procedures for Classifying and Reporting Military Equipment

The Army LOGSA uses the REQVAL to maintain official records of Army military equipment. The REQVAL classifies military equipment as Equipment in Use or Equipment in Transit primarily based on the source of input information.

- o Information input from the SPBS-R is classified as Equipment in Use, account 1762. Property book officers consider equipment in the hands of the end users to be in use.

- o Information input from the SPBS-R for Equipment in Transit, account 1770 is classified in SPBS-R reports as "due in." Accounting policy defines Equipment in Transit as items from the vendor for which title has passed.

See Appendix C for a discussion of the SPBS-R.

As stated in Finding A, DFAS-IN did not use the LOGSA information as the source for reporting FY 1995 military equipment assets because a DFAS-IN official believed that use of the LOGSA report may have resulted in duplicate reporting of nontactical equipment.

Classification of Military Equipment

DFAS-IN Regulation 37-1 defines the various classifications of military equipment. The ARNG classified \$1.2 billion of equipment due in to Guard units as equipment in use. The equipment was assigned to specific units, but had not yet arrived at the assigned units. DFAS-IN Regulation 37-1 defines

Finding B. Classification of ARNG Military Equipment Assets

such equipment, which meets or exceeds Army capitalization criteria, as equipment that has not yet been received. The equipment, therefore, should have been classified as Equipment in Transit.

Prior Review

The DFAS-IN reviewed the ARNG military equipment classification during FY 1996. In a February 26, 1996, memorandum to the Director, ARNG, DFAS-IN stated that the ARNG did not report any balances for Equipment Not in Use, account 1766,² and Equipment in Transit, account 1770. DFAS-IN questioned the absence of reported balances for accounts 1766 and 1770. The DFAS requested that the ARNG submit a corrective action plan to DFAS-IN. See Appendix B for further details.

Conclusion

The ARNG owns significant amounts of military equipment in transit. The equipment management systems in use are able to capture the data necessary to properly classify equipment as "in use," and "in-transit." Therefore, ARNG financial reports to DFAS-IN should contain the appropriate military equipment account balances.

Recommendations, Management Comments, and Audit Response

B.1. We recommend that the Director, Logistics Support Activity, provide to the Army National Guard the specific FY 1996 values of Army National Guard military equipment classified as Equipment in Use (account 1762), and Equipment in Transit (account 1770).

National Guard Bureau Comments. The National Guard Bureau provided comments, which were coordinated with and approved by the Director, Army

²The September 30, 1995 LOGSA general ledger report to DFAS-IN included a zero balance for Equipment Not in Use, account 1766. However, the LOGSA general ledger reports to DFAS-IN dated May 1, 1996, and July 1, 1996, included balances for account 1766 of \$181.5 million and \$160.2 million, respectively. We did not include Equipment Not in Use, account 1766, in the finding because the audit scope included only FY 1995; in addition, May and July 1996 balances for account 1766 were not material.

Finding B. Classification of ARNG Military Equipment Assets

Staff, and the Assistant Secretary of the Army (Financial Management and Comptroller). The National Guard Bureau concurred, stating that the Director, Logistics Support Activity, will give the Army National Guard a copy of the FY 1996 military equipment report, which the Director will furnish to the DFAS-IN. The report will include military equipment classified as equipment in use and equipment in transit.

B.2. We recommend that the Director, Army National Guard, make appropriate accounting entries to accurately record and classify FY 1996 Army National Guard military equipment assets in accordance with Defense Finance and Accounting Service, Indianapolis Center, Regulation 37-1, "Finance and Accounting Policy Implementation," September 18, 1995.

Management Comments. The National Guard Bureau concurred, stating that Equipment in Transit, account 1770, will be added to the Army National Guard general ledger account structure and that appropriate FY 1996 balances will be posted to account 1770.

B.3. We recommend that the Director, Indianapolis Center, Defense Finance and Accounting Service, make appropriate correcting accounting entries to accurately classify FY 1996 Army National Guard military equipment assets included in the Army general ledger.

Defense Finance and Accounting Service Comments. The DFAS-IN, nonconcurrent, stating that it cannot make correcting entries to the data reported by the Army National Guard. However, the Defense Finance and Accounting Service will advise the Army National Guard if the reported data are not consistent with the guidance and will request revision of the data by the Army National Guard. Additionally, the Defense Finance and Accounting Service will maintain the integrity of the military equipment classifications, as reported by the Army National Guard.

National Guard Bureau Comments. Although not required to comment, the National Guard Bureau concurred with the recommendation.

Audit Response. Although DFAS nonconcurrent with the recommendation, its comments that DFAS will make accounting entries to accurately classify ARNG military equipment satisfy the intent of the recommendation.

Part II - Additional Information

Appendix A. Scope and Methodology

Scope

We reviewed the ARNG process for recording and reporting military equipment valued at \$34.2 billion for inclusion in the Army financial statements, from the initial recording of the equipment in unit property books to the reporting of quarterly equipment balances to DFAS-IN. Also, we evaluated the capabilities of the property accountability and accounting systems that support ARNG equipment accounting.

Limitations to Audit Scope. We limited the audit scope as follows.

- o We did not include tests to determine the accuracy of military equipment property book records or to determine whether automated controls were sufficient to ensure the integrity of transmitted information.

- o We did not observe or perform physical inventory procedures for military equipment.

- o We did not attempt to reconcile financial and property records.

- o We did not review fund control procedures for awarding contracts, paying vendors, and ensuring that military equipment paid for was received.

Computer-Processed Data. We relied on computer-processed data without performing tests of system general and application controls to confirm the reliability of the data. We did not establish reliability of the data because LOGSA did not provide subsidiary records needed to authenticate the computer-processed data. However, we believe that, based on other evidence obtained, the opinions, conclusions, and recommendations in this report are valid.

Methodology

Audit Methodology. To determine whether the ARNG military equipment account balances complied with DoD and Army capitalization thresholds and classification requirements, we did the following.

- o Interviewed personnel from ARNG, DFAS-IN, and Army Staff.

- o Reviewed and analyzed ARNG military equipment balances included on the LOGSA general ledger report, dated September 30, 1995, and submitted to DFAS-IN on October 19, 1995.

- o Reviewed and analyzed ARNG FY 1995 general ledger report on military equipment, dated December 15, 1995.

- o Reviewed and analyzed DFAS-IN FY 1995 yearend adjusting journal entry for ARNG military equipment, dated November 29, 1995, to verify that DFAS-IN used ARNG direct input as the basis for recording military equipment on the FY 1994 Army financial statement.

- o Reviewed property book records of ARNG units in Delaware and Virginia dated June 1996, showing a total of 2,005 equipment line items, to determine the types, amounts, and unit costs of equipment assigned to these units.

- o Evaluated the roles and responsibilities of the ARNG Comptroller, the Defense Finance and Accounting Service, and the Deputy Chief of Staff for Logistics in formulating and executing military equipment capitalization and classification policies.

- o Reviewed and evaluated policies, procedures, and practices for recording military equipment in the ARNG general ledger and for reporting military equipment account balances to DFAS-IN.

- o Reviewed the Army policies, procedures, and practices for recording and classifying the value of military equipment for Army components and for reporting military equipment balances and equipment classifications to DFAS-IN.

- o Discussed the recording and reporting of military equipment with DFAS-IN officials.

- o Determined the specific types of military equipment recorded as assets as of September 30, 1995, in the ARNG general ledger and compared the types and values to Army policies.

Audit Period and Standards. We performed this financial-related audit from March through August 1996 in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD. Accordingly, we included such tests of management controls considered necessary.

Organizations and Individuals Visited or Contacted

Contacts During the Audit. We visited or contacted individuals and organizations within the DoD. Further details are available upon request.

Management Control Program

DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987,* requires DoD organizations to implement comprehensive systems of management controls that provide reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of Review of the Management Control Program. We reviewed the ARNG FY 1995 management control program to determine whether the ARNG:

- o evaluated risk associated with accurate and reliable recording of military equipment transactions in the ARNG general ledger,
- o had effective management control techniques in place to ensure that military equipment transactions were properly classified and recorded in the general ledger, and
- o performed a self-evaluation of those techniques to make certain the controls worked.

Adequacy of Management Controls. We identified material management control weaknesses, as defined by DoD Directive 5010.38, at the ARNG. The ARNG did not have management controls to ensure that only military equipment assets that met the Army capitalization threshold were capitalized. The ARNG also did not have management control techniques to ensure that military equipment assets included in the ARNG general ledger were properly classified. The specific control weaknesses are discussed in the findings. The recommendations in this report, if implemented, will improve the accuracy and reliability of military equipment account balances in the ARNG general ledger. We will provide a copy of this report to the senior official in charge of management controls for the Army National Guard.

Adequacy of Management's Self-Evaluation. The ARNG FY 1995 self-evaluations did not identify the specific material management control weaknesses identified by the audit. The ARNG did not identify the weaknesses because it did not assess the risks of recording in the general ledger military equipment assets that did not meet the Army capitalization threshold and because the ARNG did not assess the risk of not properly classifying recorded assets.

*Revised August 26, 1996, as DoD Directive 5010.38, "Management Control (MC) Program."

Appendix B. Prior Audits and Other Reviews

Army Audit Agency

Report No. AA 96-156, "Financial Reporting of Equipment In Transit," June 17, 1996. The report states that the Army Audit Agency determined that DFAS-IN did not use equipment information, even though it was available in the LOGSA general ledger report for the ARNG, because the ARNG submitted a summary of its on-hand equipment balances directly to DFAS-IN. Every month, LOGSA provides DFAS-IN the general ledger report, which includes only equipment with a unit cost of \$50,000 or more, for financial reporting purposes. The report also states that not all Guard reporting units were using the SPBS-R on which the general ledger report is based.

The report concludes that the ARNG should complete the conversion of its property book system by the end of FY 1996 in order to use the CBS-X general ledger report.

The report recommends that the Deputy Chief of Staff for Logistics request that the ARNG require all units to convert to the standard property book system and, when completed, direct the LOGSA and the ARNG to coordinate with DFAS-IN in developing procedures for using the CBS-X general ledger report as the subsidiary ledger for the ARNG military equipment.

The Deputy Chief of Staff concurred with the recommendation, but stated that ARNG would not be fully converted to SPBS-R until after the year 2000. The Deputy stated that his office would, if necessary, investigate speeding up the conversion of ARNG units to the SPBS-R.

Report No. AA 96-152, "Examination of the Army's Financial Statements for Fiscal Years 1995 and 1994," March 15, 1996. The report states that the Army Audit Agency was unable to express an opinion on the Army financial statements for FYs 1995 and 1994 for reasons that included inadequate accounting systems. For example, most of the property accountability systems cannot comply with current DoD financial capitalization and historical cost reporting requirements. Consequently, those systems inappropriately used the FY 1995 capitalization threshold of \$50,000 for all assets, regardless of when they were acquired.

Defense Finance and Accounting Service, Indianapolis Center

DFAS-IN Memorandum to Director, ARNG, "Breakdown in ARNG Accounting Controls for Year-end Reporting for the Army Financial

Appendix B. Prior Audits and Other Reviews

Statements," December 11, 1995. The memorandum states that the ARNG may not have complied with DoD capitalization criteria and generally did not follow general ledger reporting procedures. The memorandum recommends that the ARNG report a material weakness in the Army Annual Statement of Assurance until such time as the necessary operating procedures are in place and operating as intended. The DFAS restated, in a February 26, 1996, followup memorandum to the Director, ARNG, the potential noncompliance and questioned the absence of reported balances for Equipment Not in Use, account 1766; Equipment in Transit, account 1770; and other general ledger accounts into which military equipment can be classified.

The DFAS requested that the ARNG submit a corrective action plan within 30 days of the date of the followup memorandum. As of May 1996, the ARNG had not submitted the plan. However, a plan is no longer necessary. Beginning in June, 1996, the DFAS obtained ARNG military equipment balances from the LOGSA general ledger report, which applies capitalization and classification criteria.

Appendix C. Primary Property Accountability Systems

The four principal property accountability systems used to track and report ARNG equipment are discussed below.

SPBS-R

The SPBS-R is a fully interactive, automated Army property accounting system that performs functions of property accounting required by Army regulations. The SPBS-R tracks military equipment in use and in transit and provides other features of asset visibility required by ARNG equipment managers. The U.S. property book officers for the state Guard units use the SPBS-R to maintain equipment accountability and to report as required to ARNG headquarters and to the CBS-X system and REQVAL. The SPBS-R, by virtue of being the initial level of equipment accountability and tracking, is the source of data for military equipment balances reported in Army financial statements.

The SPBS-R shows equipment unit cost based on standard costs used Army-wide and periodically updated to show the most recent acquisition cost of equipment items. The cost of an item is, therefore, not always the historical cost of that item. Additionally, the system does not track acquisition dates. The data in the system, therefore, do not permit the ARNG to capitalize equipment in accordance with DoD thresholds in effect as of individual equipment acquisition dates.

SAMIS

The SAMIS is the property accountability system used for stock control functions, including tracking of excess equipment in the state warehouses. Equipment managers remove equipment data from the SPBS-R and enter them into the SAMIS when the managers determine the equipment to be excess to state Guard requirements and send the equipment to the warehouses to await disposition instructions. ARNG officials plan to replace the SAMIS with a new system in FY 1997.

CBS-X

The CBS-X is an automated, transaction-driven equipment accounting system. Army users input supply and equipment transactions to maintain centralized Army-wide visibility of reportable equipment at the unit (property book) and depot levels. Electronic media provide updates to CBS-X data for on-hand and excess major equipment items. Equipment data maintained in the CBS-X is the source of equipment accounting data for the REQVAL.

REQVAL

The REQVAL maintains data on equipment enabling the REQVAL to provide Army and ARNG users with major item information regarding authorizations, on-hand balances, and other data required by equipment managers. REQVAL takes source data for major equipment items from the CBS-X. Although the primary focus of the REQVAL is on logistics issues, LOGSA programmed REQVAL to produce monthly general ledger reports that show on-hand and in-transit equipment balances by type of equipment (aircraft, tanks, etc.) and major command. The general ledger report program also applies the current Army capitalization threshold.

Appendix D. Data Flow from Property Book to General Ledger

Property Book

Property book officers at the unit level enter military equipment asset data into the SPBS-R when the assets become the property of the ARNG. Equipment in transit is shown on the property book records as "due in." Equipment that has arrived at the user's location is shown as "on hand." The property book records show the equipment by line item number, assigned unit, unit cost, quantity on hand and due in, and other data important for equipment management, but not needed to support financial accounting for equipment.

Equipment that has been identified as excess to unit requirements and turned in to the state warehouse is removed from the SPBS-R records. This equipment is tracked by the SAMIS, which shows data similar to that shown in SPBS-R records.

The unit-level property book records are consolidated at the state level for all Guard units. This consolidation provides equipment managers with equipment visibility for equipment management purposes. The consolidation also provides centralized equipment records that are used to update records, for the entire ARNG, that are maintained in the CBS-X. Users also use data in SAMIS to update the CBS-X.

LOGSA

The Army LOGSA maintains the CBS-X, which tracks military equipment Army-wide. The CBS-X is transaction driven, making it dependent on accurate input from the state Guard property book systems. Equipment data in the CBS-X is periodically transmitted electronically to the REQVAL, also maintained by LOGSA. The REQVAL performs equipment requisition and management control functions and can generate reports showing equipment balances by state and type of equipment.

REQVAL reports are for equipment management purposes, but are also used for financial reporting and include financial data. The ARNG uses financial data from REQVAL to report to DFAS-IN on a quarterly basis. Before June 1996, the ARNG reported balances for tactical and nontactical equipment to DFAS-IN. Beginning with the June 1996 report, the ARNG provides data only for nontactical equipment. However, the REQVAL also produces a general

Appendix D. Data Flow from Property Book to General Ledger

ledger report, for tactical equipment, that includes data required for adequate financial reporting. LOGSA provides the general ledger report directly to DFAS-IN.

DFAS-IN

The DFAS-IN consolidates the data received from LOGSA and ARNG and includes those balances in the Army financial statement balance for military equipment.

Appendix E. ARNG Military Equipment Balances as of September 30, 1995

<u>Reporting Unit</u>	<u>Balance (millions)</u>
Alabama	\$1,592.9
Alaska	167.0
Arizona	220.9
Arkansas	569.6
California	1,870.2
Colorado	214.7
Connecticut	209.4
Delaware	112.7
District of Columbia	56.8
Florida	963.0
Georgia	996.7
Hawaii	163.4
Idaho	809.5
Illinois	465.5
Indiana	533.0
Iowa	458.1
Kansas	777.1
Kentucky	719.3
Louisiana	780.8
Maine	98.6
Maryland	328.0
Massachusetts	390.5
Michigan	755.0
Minnesota	722.7
Mississippi	1,401.8
Missouri	755.8
Montana	475.4
Nebraska	415.8
Nevada	253.4
New Hampshire	84.2
New Jersey	994.9
New Mexico	632.0
New York	989.0
North Carolina	1,301.6
North Dakota	183.1
Ohio	1,101.7
Oklahoma	392.1
Oregon	507.9
Pennsylvania	1,651.2
Rhode Island	188.0
South Carolina	1,489.2
South Dakota	161.3
Tennessee	799.5

Appendix E. ARNG Military Equipment Balances as of September 30, 1995

<u>Reporting Unit</u>	<u>Balance (millions)</u>
Texas	2,847.2
Utah	444.1
Vermont	552.3
Virginia	413.1
Washington	922.3
West Virginia	258.7
Wisconsin	690.4
Wyoming	118.1
Guam	7.6
Puerto Rico	213.0
Virgin Islands	<u>22.4</u>
Total	\$34,242.5

Appendix F. Report Distribution

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Senate Committee on Armed Services
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Part III - Management Comments

Defense Finance and Accounting Service Comments



DEFENSE FINANCE AND ACCOUNTING SERVICE

1931 JEFFERSON DAVIS HIGHWAY
ARLINGTON, VA 22240-5291

DEC - 3 1996

DFAS-HQ/AFB

MEMORANDUM FOR DIRECTOR, READINESS AND OPERATIONAL SUPPORT
DIRECTORATE, OFFICE OF THE INSPECTOR GENERAL,
DEPARTMENT OF DEFENSE

SUBJECT: Draft Audit Report on Army National Guard Military
Equipment (Project No. 6RE-2016.01)

The Defense Finance and Accounting Service has reviewed
the draft audit report findings and recommendations. Our
response to Recommendation B.3. is attached.

If you have any questions, my point of contact on this
audit is Mr. Thomas Tresslar, (703) 607-1120.

Thomas F. McCarty
Deputy Director for
Accounting

Attachment

CC:
DFAS-HQ/PA
DFAS-IN/A

Defense Finance and Accounting Service (DFAS) Response to the
Office of the Inspector General, DoD
Draft Audit Report, Army National Guard Military Equipment
Project No. 6RE-2016.01

RECOMMENDATION B.3. That the Director, Indianapolis Center, Defense Finance and Accounting Service, make appropriate correcting accounting entries to accurately classify FY 1996 Army National Guard military equipment assets included in the Army general ledger.

DFAS RESPONSE. Nonconcur. DFAS cannot make correcting entries to the data reported by the Army National Guard. However, the DFAS-Indianapolis Center will advise the Army National Guard if the reported data is not consistent with the guidance and will request revision of the data by the Army National Guard. DFAS will maintain the integrity of the military equipment classifications, as reported by the Army National Guard. For example: If the Army National Guard reports military equipment in account 1762 Equipment in Use, account 1766 Equipment Not in Use, and account 1770 Equipment in Transit, DFAS will maintain the integrity of such reported classifications. In past years, Army National Guard military equipment has been reported in only one account, as noted in the audit report.

DFAS-Indianapolis Center must rely on the reporting entity to properly categorize reported military equipment. DFAS-Indianapolis Center is not in a position to make independent, unsupported correcting accounting entries without supporting data from the reporting entities.

As the report notes, DFAS-Indianapolis has provided sufficient guidance regarding equipment capitalization criteria and general ledger treatment.

National Guard Bureau Comments



DEPARTMENTS OF THE ARMY AND THE AIR FORCE
NATIONAL GUARD BUREAU
111 SOUTH GEORGE MASON DRIVE
ARLINGTON, VA 22204-1382

NGB-ARC (36-5d)

19 NOV 1996

MEMORANDUM THRU

~~DIRECTOR, ARMY NATIONAL GUARD, THE PENTAGON, WASHINGTON, DC 20310~~
Edmund J. [Signature] *11/22/96*
~~ASSISTANT SECRETARY OF THE ARMY FOR FINANCIAL MANAGEMENT AND
CONTROLLER (ASA(FM&C)), THE PENTAGON, WASHINGTON, DC 20310~~

FOR DEPARTMENT OF DEFENSE INSPECTOR GENERAL (DODIG), DIRECTOR,
READINESS AND OPERATIONAL SUPPORT DIRECTORATE, THE PENTAGON,
WASHINGTON, DC 20310

SUBJECT: Audit Report on Army National Guard (ARNG) Military
Equipment (Project No. 6RE-2016.01)

1. The following management comments are provided relative to
subject audit:

a. Finding A. Capitalization of Department of Defense (DOD)
Equipment Assets.

Recommendation A.1: "Record and report ARNG military
equipment using the capitalization thresholds established by the
Logistics Support Activity for Army major commands (MACOMs), and
make appropriate FY 1996 accounting entries to record ARNG
military equipment assets on the ARNG general ledger."

Recommendation A.2: "Document the specific procedures
established to record ARNG equipment for financial reporting."

Management Comments: Concur with finding and
recommendations. The ARNG did not properly apply the
capitalization threshold of \$50,000 when recording military
equipment in general ledger asset accounts. Adjusting entries
will be made to properly record military equipment in general
ledger asset accounts with respect to capitalization thresholds.
These adjustments will be reflected in the 30 September 1996 ARNG
general ledger.

The ARNG accounting systems do not provide general ledger
accounting and reporting at the fiscal station level. The ARNG
general ledger crosswalks budget execution data reported monthly
by the fiscal stations to the general ledger accounts. Asset

NGB-ARC

SUBJECT: Audit Report on Army National Guard (ARNG) Military Equipment (Project No. 6RE-2016.01)

accounts are manually updated based on data obtained from property book systems. There is no validation of general ledger balances at the fiscal station level. A fiscal station level general ledger process has been programmed in the State Accounting, Budget Execution and Reservation System (SABERS) for deployment during FY97. Fiscal station personnel will be responsible for posting and maintaining general ledger balances, and for conducting reconciliations with property book and logistics systems data. Fiscal station level general ledger will be tested in November 1996 with fielding to be completed by March 1997. Documentation for fiscal station and ARNG level general ledger reporting will be completed upon completion of fielding.

b. Finding B. Classification of ARNG Equipment Assets.

Recommendation B.1. "We recommend that the Director, Logistics Support Activity (LOGSA), provide the ARNG the specific FY 1996 values of ARNG military equipment classified as Equipment in Use (account 1762), and Equipment in Transit (account 1770)."

Recommendation B.2. "We recommend that the Director, ARNG, make appropriate accounting entries to accurately record and classify FY 1996 ARNG military equipment assets in accordance with Defense Finance and Accounting Service, Indianapolis Center (DFAS-IN) Regulation 37-1, "Finance and Accounting Policy Implementation," September 18, 1995."

Recommendation B.3. "We recommend that the Director, DFAS-IN, make appropriate correcting accounting entries to accurately classify FY 1996 ARNG military equipment assets included in the Army general ledger."

Management Comments: Concur with finding and recommendations. The ARNG general ledger process is being modified to include the equipment in transit account (account 1770). Appropriate balances will be posted to this account for FY 1996 general ledger reporting. The DFAS-IN has requested that the ARNG report only Table of Distribution and Allowances (TDA) military equipment balances. The DFAS-IN will obtain and report Table of Organization and Equipment (TOE) military equipment balances. The Director, Logistics Support Activity

National Guard Bureau Comments

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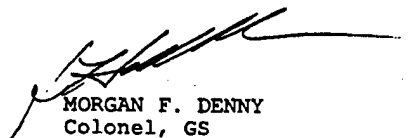
SUBJECT: Audit Report on Army National Guard (ARNG) Military Equipment (Project No. 6RE-2016.01)

will provide to the ARNG a copy of the FY96 report on TOE equipment which they furnish to DFAS.

2. In addition to the corrective actions outlined above, the ARNG has taken several measures to strengthen the management control process. During FY 1996, we implemented direct reporting of monthly financial reports from our fiscal stations directly to DFAS-IN. Direct reporting will eliminate overlapping and redundant systems and processes, standardize ARNG reporting practices with those of the Army, and will enable preparation of MACOM level financial reports and statements, including general ledger, by DFAS-IN in compliance with DOD reporting requirements. The ARNG's unique accounting system, SABERS, has been identified as a material weakness in our annual assurance statement of internal controls since 1988. The Corps of Engineers Financial Management System (CEFMS) will replace SABERS. The Under Secretary of Defense, Comptroller, has designated CEFMS as the official accounting system for Army customers of DFAS-IN. We plan to begin an evaluation of CEFMS during FY 1997, with deployment to start during FY 1998.

3. I appreciate the assistance provided by the DOD IG audit staff during the April through September 1996 period of audit work. I will keep you posted on events that may affect areas covered by this audit. My points of contact are Ms. Pat Condon, or Mr. John Argodale, (703) 607-7704 or (703) 607-7510 respectively.

FOR THE CHIEF, NATIONAL GUARD BUREAU:


MORGAN F. DENNY
Colonel, GS
Director, Army Comptroller

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This report was prepared by the Readiness and Operational Support Directorate, Office of the Assistant Inspector General for Auditing, DoD.

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